The President's Budget for FY 2002

Overview and Analysis

Senate Budget Committee Democratic Staff

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Social Security and Medicare Are Not Protected in President Bush's Tax Cut Masquerading as a Budget

- **The Bush budget breaks the consensus that all of the Social Security and Medicare Hospital Insurance (HI) surpluses should be preserved for those programs and used to pay down the debt**. The President proposes that $1.1 trillion of the $3.1 trillion Social Security and Medicare HI surpluses should instead be used for other, largely unspecified, purposes.

- **The Bush budget is not a real budget – it is a tax cut masquerading as a budget**. The budget specifically calls for a $2 trillion tax cut (including increased interest costs resulting from the tax cut) that disproportionately benefits the wealthiest one percent of Americans but ducks the responsibility to detail other priorities, simply pretending all other national needs can be funded out of a pot of "reserve" funds.

- **The Bush budget avoids details because those details would show clearly that the numbers don't add up. We simply cannot afford such a large tax cut and still eliminate the debt and meet high priority national needs.** When properly accounted for, the $1.4 trillion "reserve" the Bush budget says is available to meet "additional needs" (everything other than the tax cut) would not even cover the costs of maintaining current policies that everyone knows will be maintained but are not recognized in the Bush budget – extending popular expiring tax credits, keeping the alternative minimum tax from affecting millions of additional taxpayers, and maintaining the current level of support for struggling farmers – much less the costs of new policy initiatives, such as a missile defense system, that the President proposed during the campaign.

The President's Budget Framework

The Administration estimates that surpluses will total $5.6 trillion in fiscal years 2002 through 2011. Of those surpluses, $2.6 trillion is in the Social Security trust funds and $500 billion is in the Medicare Hospital Insurance (HI) Trust Fund.

The President claims he sets aside the $2.6 trillion Social Security surplus, but he does not even pretend to set aside the Medicare HI surplus. He proposes to use $2 trillion of the Social Security surplus to pay down debt held by the public and to reserve $600 billion of the surplus for Social Security "reform," which the budget defines as at least partial privatization of Social Security. Using this money for privatization would lead either to Social Security benefit cuts or move up the date of trust fund insolvency.

The remaining surplus of slightly more than $3 trillion would be devoted primarily to a massive tax cut. The Administration estimates that the tax cut will cost $1.6 trillion over the next decade, but just taking into account the resulting increase in federal interest costs pushes that amount up to $2 trillion. The cost is likely to be even higher when the Joint Committee on Taxation estimates the President's tax proposals. In addition, other costs that are not reflected in the President's budget – such as the cost of accelerating proposed rate reductions, extending expiring tax credits, and reforming the alternative minimum tax – would raise the cost even higher.

Table 1: The President's FY 2002 Budget Framework

($ billions)	2002-11
Projected total surplus	**5,644**
Social Security surplus reserved to pay down debt	-2,000
Social Security surplus not reserved	-591
Remaining surplus	**3,053**
Allocation of surplus:	
Bush tax cut	-1,990
Tax cut changes	*-1,620*
Interest on tax cuts	*-370*
Prescription drug benefit	-153
Discretionary spending adds	-30
Mandatory cuts (net)	+9
Contingency spending fund	-842
Interest costs on spending policy	-47
Total changes	-3,053
Remaining surplus	**0**

Non-tax policy proposals are much more modest. The President proposes to spend $153 billion over ten years for a Medicare prescription drug benefit and Medicare reform and to reduce spending for other mandatory programs by a net of $9 billion (including a $17 billion cut in Medicaid and the State Child Health Insurance Program).

This leaves $842 billion in a so-called "reserve" that the President says could be used to meet "additional" needs that are not specifically addressed in his budget – such as a missile defense system. But this includes $526 billion in Medicare HI surpluses. When you exclude the Medicare surplus and take into account the costs of simply maintaining current policies in regards to expiring tax credits, the alternative minimum tax, and aid to distressed farmers, the reserve fund is more than used up. That means no funds would be available to meet any additional needs unless further cuts are made in other programs or less debt is paid down. And it means no funds are available to help strengthen Social Security.

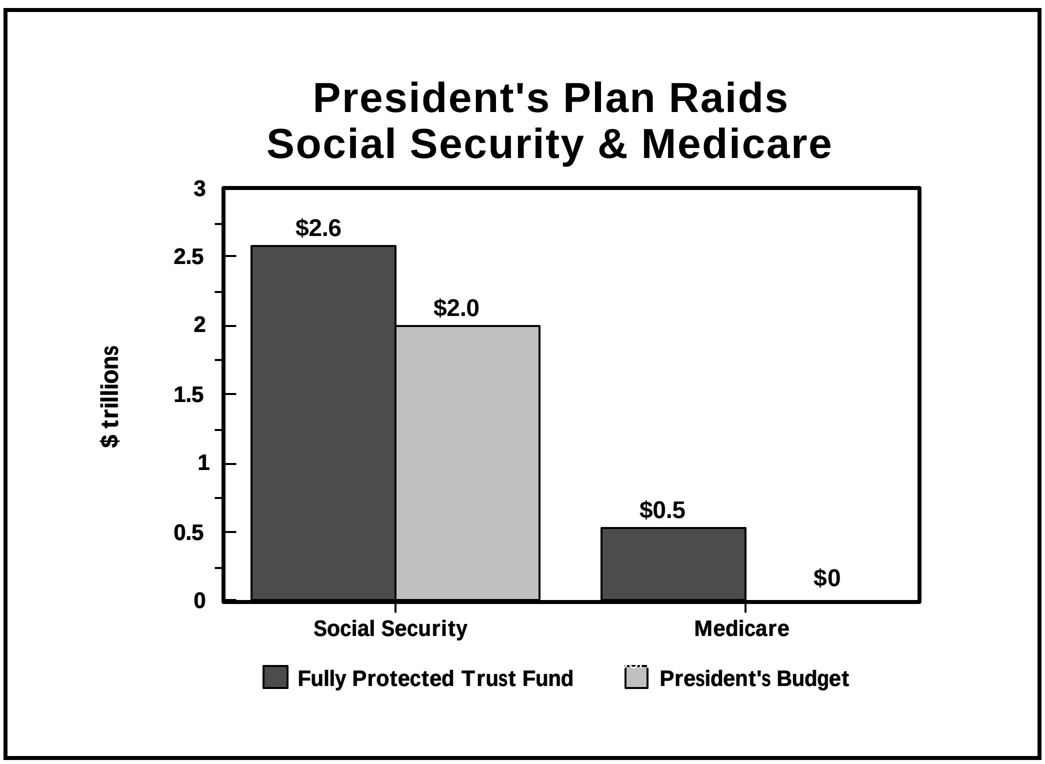
Trust Funds

Although the budget claims that all of the Social Security trust fund surpluses have been preserved for Social Security, the President has departed dramatically from the position supported by Congressional Republicans and Democrats that the entire $2.6 trillion surplus should be locked away for debt reduction. The President proposes using $2 trillion of the surplus for that purpose but takes the remaining $600 billion of the surplus and sets it aside to partially privatize Social Security.

For the last several years, Republicans and Democrats alike have consistently argued that every penny of the Social Security surplus should be set aside for debt reduction. In votes taken last week in the House and last June in the Senate, 407 House Members and 98 Senate Members voted to lock up Social Security and Medicare surpluses for debt reduction and to free up future budget resources for the retirement of the baby boom generation. Key Republicans have gone so far as to take credit for the "lockbox" concept. Yet, by proposing to raid the Social Security surplus to fund private Social Security accounts, the Bush budget fails to meet the lockbox test.

It is appropriate to consider setting aside some of the non-Social Security surpluses to help deal with the long-term retirement problem, but all of the Social Security surpluses are needed to meet currently promised Social Security benefits.

The Bush budget goes even further in the case of Medicare, using an accounting gimmick to claim there is no Medicare surplus so that the surpluses could be included in their "reserve" that is supposed to be available to meet "additional" needs. Despite the Administration's claim that there is no Medicare surplus, the nonpartisan Congressional Budget Office projects that the Medicare HI and Supplementary Medical Insurance (SMI) trust funds will have a combined surplus of $405 billion in 2002 through 2011.

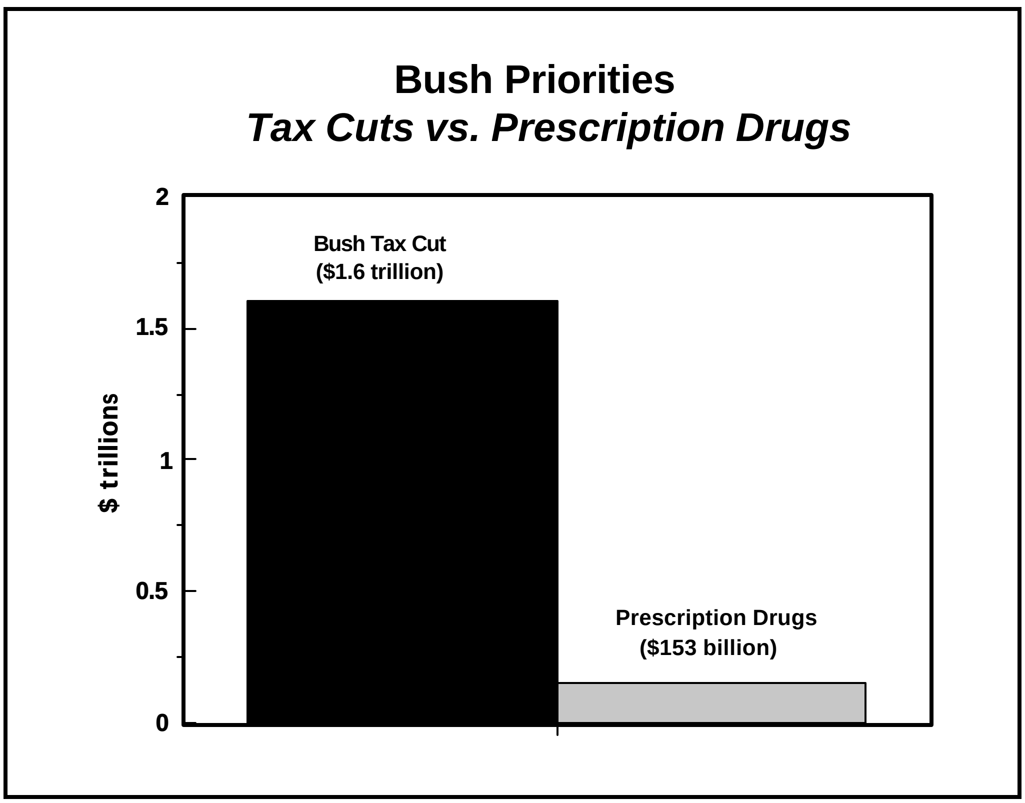


Although the Administration claims that the SMI fund has a massive deficit over the next 10 years (because it doesn't count the general fund support the program is due under current law), it actually estimates that the HI surplus is $526 billion, more than $100 billion higher than CBO estimates. All of that $526 billion should be set aside for Medicare and not be made available for purposes other than paying down the debt.

Tax Cuts

According to the Administration, the tax cut will cost $1.6 trillion over the next 10 years, more than 10 times the amount allocated for a Medicare prescription drug benefit and Medicare reform. But the Administration's estimate substantially understates the true cost of the tax cut. Just adding the nearly $400 billion in additional interest payments that will result from reducing revenues (thereby increasing debt relative to the baseline projections) increases the cost of the tax cut to $2.0 trillion.

But that $2 trillion almost certainly still understates the true cost of the Bush plan. The Joint Committee on Taxation (JCT) last year produced an estimate of the tax cut plan that was consistent with a $1.6 trillion cost. But conditions have changed since then. For instance, the Administration now includes additional tax incentives (such as tax credits related to the purchase of health insurance) in its plan that were not included in JCT's estimate last year. Furthermore, surplus estimates have increased largely because the Administration and CBO now believe incomes will be higher, which will increase federal revenues. The Bush proposals to cut rates will, therefore, almost certainly cost more than JCT estimated last year.



In addition to being very expensive, the Bush tax plan is not fair. Despite the Administration's boast that the plan gives the lowest income families the largest percentage reduction, the fact is that the very wealthiest Americans – the top one percent – will receive more than 40 percent of the benefits.

Paying Down the Debt

The Bush budget claims that $1.2 trillion of publicly held debt will not be available for redemption in 2011 because it will be composed of securities that have not yet matured and whose owners would demand payments of $50 billion to $150 billion greater than the value of the bonds to redeem them early. However, the $1.2 trillion figure greatly exaggerates the amount of such debt.

CBO estimates that the amount of debt that would be difficult to redeem will be $818 billion in 2011; Fed Chairman Greenspan put the figure at about $750 billion; and the official in charge of the successful debt buyback program in the Clinton Treasury puts it at $500 billion. The Administration's calculation assumes a passive Treasury that continues to issue notes and bonds that would mature beyond 2011 even as the debt is shrinking and a Treasury that takes no further action to buy back debt.

An aggressive Treasury that was interested in reducing the debt could take a number of actions to cut the amount of hard-to-redeem debt to half the Administration's figure without incurring unacceptable costs. These would include ceasing to issue longer-term debt, continuing a prudent buyback program, and repurchasing nonmarketable debt such as savings bonds and Treasury securities held by the Thrift Savings Plan.

"Reserve"

The Bush budget claims to create "an unprecedented $1.4 trillion reserve for additional needs, debt service, and contingencies." Realistically, however, none of that $1.4 trillion will be available for any unspecified new policy initiatives.

First, $153 billion of this reserve has been committed to pay for a Medicare prescription drug benefit and for Medicare reform. An additional $21 billion goes to pay for other spending proposals in the Bush budget. And more than $400 billion goes to pay the increased interest costs that will result from the President's specified tax and spending proposals (most of the cost stems from the tax cut). The increased interest costs flow directly from the proposals in the President's budget. They hardly qualify as "unforseen needs or ... programmatic reforms that are needed to shore up the long-term economic and fiscal outlook" that the budget claims the reserve is for.

The remaining $842 billion still does not represent a real reserve. More than $500 billion of this comes from the Medicare HI surplus that the Congress has agreed should be set aside just for Medicare and debt reduction. And the remaining amount would not even be enough to cover the costs of maintaining current policies that everyone knows will be maintained but that are not assumed in the Bush budget – permanently extending popular expiring tax credits, making sure the alternative minimum tax does not affect an ever-growing share of taxpayers, and maintaining payments to distressed farmers at current levels instead of allowing them to fall dramatically.

Once the Medicare HI trust fund is set aside and the cost of maintaining these current policies is taken into account, the "reserve" is more than $200 billion in deficit. Obviously, there is nothing left to help strengthen Social Security in the long run, to provide for national security requirements (including missile defense), or to provide a hedge against uncertainty.

Table 2: Reserve Fund in the President's FY 2002 Budget

($ billions)	2002-11
Reserve for additional needs	**1,433**
Medicare reform and helping hand	-153
Additional spending (net)	-21
Interest on tax cut and spending	-417
Remaining contingency fund	**842**
Remove Medicare trust fund	-526
Extenders	-41
AMT	-308
Agriculture spending	-100
Interest on adds	-95
Fund balance	**-228**
Other possible demands on the Bush "reserve"	
Social Security resources for the long term	???
National security requirements including missile defense	???
Hedge for uncertainty	???

What's In the Bush Budget???

A $2 trillion Tax Cut <u>In</u> Means Everything Else Is <u>Out</u>

What's Out...	***What's In...***
Paying down the debt	No can do. Pass $1 trillion on to future generations.
Protecting the Social Security trust fund	$591 billion in trust fund dollars "commissioned" for privatization and other purposes
Protecting the Medicare HI trust fund	Eliminating the HI trust fund
Tax cuts for *working* Americans	Tax cuts for *wealthy* Americans
A universal, comprehensive prescription drug benefit in Medicare	A short-term, inadequate cash benefit to States
Expanding health insurance coverage	Expanding tax cuts
Investment in education	Underfunding education
High priority domestic investments in the environment, law enforcement, nuclear cleanup, housing	7 percent cut in most domestic programs
A strong defense	No guaranteed resources for defense
A commitment to family farmers	No guaranteed resources for agriculture
A balanced approach to the budget	***A tax cut masquerading as a budget***